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BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF HAWAII

----- In the Matter of ----- )  
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PUBLIC UTILITIES COMMISSION )  
 )  
Instituting a Proceeding to Investigate the )  
Issues and Requirements Raised by, and )  
Contained in, Hawaii Revised Statutes )  
Chapter 486H, as Amended )  
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DOCKET NO. 05-0002

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COMMISSION

HAWAII PETROLEUM MARKETERS ASSOCIATION'S  
PROPOSALS TO (I) CREATE MARKETING MARGIN FACTORS FOR DIFFERENT  
CLASSES OF TRADE AND (II) ADJUST GAS CAP FACTORS FOR ETHANOL  
REQUIREMENTS

and

CERTIFICATE OF SERVICE

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ASSOCIATION

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HAWAII PETROLEUM MARKETERS ASSOCIATION'S  
PROPOSALS TO (I) CREATE MARKETING MARGIN FACTORS  
FOR DIFFERENT CLASSES OF TRADE AND  
(II) ADJUST GAS CAP FACTORS FOR ETHANOL REQUIREMENTS

Pursuant to Order No. 22056 of the Public Utilities Commission ("PUC"),<sup>1</sup> the Hawaii Petroleum Marketers Association ("HPMA"), by and through its attorneys, Cades Schutte LLP, hereby submits its proposals to (i) create marketing margin factors for different class of trade, and (ii) to adjust Hawaii Revised Statutes ("HRS") § 486H-13 factors to include the addition of ethanol requirements which take effect on or about April 2006.

HPMA's proposals are based on the arguments below and confidential information that will be submitted directly by HPMA members under seal pursuant to the Protective Order No. 21669. Given that jobbers operate in a highly competitive industry, any individually submitted proprietary information of HPMA members is extremely confidential

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<sup>1</sup> Filed September 28, 2005, in Docket No. 05-0002, as amended by letter dated November 2, 2005, which extended HPMA's response due date to December 1, 2005.

and, if divulged, would cause irreparable damage to the respective HPMA member's operations and competitiveness in the marketplace.

I. PROPOSAL TO CREATE MARKETING MARGIN FACTORS FOR DIFFERENT CLASSES OF TRADE.

A. Marketing Margin Protections Necessary. HPMA believes that the existing global marketing margin factor of 18 cpg established under HRS §486H-13(e) for all classes of trade leaves the jobber industry vulnerable to detrimental exploitation by the larger upstream suppliers in the wholesale petroleum supply industry. Without protections for adequate marketing margins for delivery to the retail stations, Hawaii jobbers face the prospect of having their margins reduced by larger suppliers intent on preserving their traditional margins. The effect of such actions would make it unprofitable for jobbers to deliver to both retail stations and other segments of their business.

Importantly, jobbers need marketing margin protections to enable them to provide services to those customers that the larger distributors will not or cannot service. Such customers include:

- small customers, small deliveries;
- remote locations;
- customers wanting longer credit or with poor credit;
- customers needing extra service such as fuel tanks in the field; and
- customers that need additional products such as lubricants.

The PUC needs to ensure the survival of the Hawaii jobber industry and the services it provides to these customers which are being jeopardized by regulations that interfere with the free market (in a free market, these at-risk customers would pay for the services that the jobbers provide).

This holds especially true for the neighbor islands, where, without jobbers, most businesses that consume petroleum products would effectively come to a halt. For instance, jobbers provide the wholesale petroleum deliveries to most of the county, state and federal accounts in addition to supplying the business communities with fuel and related products. Jobbers also provide the vast majority of fuel deliveries on the neighbor islands to customers other than retail stations, but the retail stations account for a large percentage of their volume.

Without protections of adequate margins for delivery to the retail stations, jobbers face the prospect of having their margins squeezed further by the suppliers, thus making it unprofitable to deliver to both retail stations and other segments of their business. In other words, if jobbers lose their retail station business, they are at risk of either having to charge substantially more for their services to non-retail station customers or go out of business altogether. This would not be in the best interest of the Hawaii business community or the public.

Jobbers are also important in that they provide competition to the refiners and large distributors in many markets where these industry participants would otherwise have a duopoly (or oligopoly). The gas cap regulations creates the potential for jobbers to be squeezed out of such markets.

Therefore, to provide the necessary protection of the marketing margin factor, HPMA proposes that the PUC create marketing margin factors for different classes of trade based upon recommendations made by ICF Consulting, LLC ("ICF") in its report entitled "Implementation Recommendations for Hawaii Revised Statutes Chapter 486H, Gasoline Price Cap Legislation," dated April 15, 2005 (the "ICF Report").

Specifically, the ICF Report provides at page 2:

The marketing margin factor stated in 486H-13(e) (Task C) is 18 cpg. The legislation is silent on the definition of this margin. The Oil Industry has several classes of wholesale trade leading to a delivery to a retail service station. These include a) bulk sales into pipelines, barges, or ships, b) sales from a terminal rack ("Rack sales") into a distributor or jobber's truck, and c) Dealer Tankwagon sales (DTW), or delivered sales from a supplier to the service station dealer. Both the Rack and DTW sales may be "branded" or "unbranded". Branded sales are made to dealers, distributors or jobbers who sell gasoline under the brand of the seller; unbranded sales are made to dealers, distributors or jobbers who sell gasoline under their own brand.

**The different classes of trade cannot be regulated under one common margin.** For example, bulk sales take place at price levels at or near spot market conditions, which typically generate very little marketing margin. Rack sales are sold FOB a petroleum terminal loading rack, and command a price that provides a profit level above the cost to transport the gasoline to the terminal. Branded rack sales are typically sold at a premium to unbranded rack sales because branded customers have a contractual relationship with sellers that provide branded customers with supply reliability, branded gasoline additives, and marketing support under the seller's trade name. Unbranded customers normally get a lower price, with no branded additives or supply assurance, and risk of higher-than-branded prices when supply is tight. Customers who buy on a DTW basis pay additional cost to have product delivered by the supplier to the service station; branded dealers buying on a DTW basis additionally receive support from the seller in supply reliability, marketing guidance, and cost offsets.

In addition, there can often be multiple wholesale transactions prior to delivery to a service station. For example, Refiner ABC may sell gasoline on a bulk basis to company DEF, who sells gasoline to a branded distributor XYZ at a branded Rack price, who sells gasoline on a DTW basis to a service station. ICF is recommending extensive adjustments to 486H-13(e) to provide a different marketing margin for each class of trade in Hawaii.

(emphasis added).

Under Task C (Marketing Margin Factor) of the ICF Report, ICF recommended that multi-layered marketing margin adjustments be made for each class of trade (i.e., bulk (1 cpg), DTW or Dealer Tankwagon (15 cpg), branded rack (6.7 cpg), and unbranded rack (9.7 cpg)). HPMA supports ICF's recommendations for the bulk and branded rack classes of trade, but recommends a DTW cap (i.e., delivered price to the station) which is no lower than the law's 18 cpg marketing margin adjustment.

ICF's recommendations to break down the marketing adjustment factors by class of trade is sound based on the different levels of negotiating and market strength in each segment of the industry. It is more than likely that if the base price cap is set at a point negatively impacting the expected margins of an upstream supplier (e.g., refiner), then the marketing margin will become fertile ground for that supplier to recapture any unrealized margin under the base price cap. Wholesale suppliers further downstream would ultimately be impacted by such a move and would find themselves with their backs against the aggregate wholesale cap wall.

By establishing firm marketing adjustment factor caps among the classes of trade, the downstream participants would have their portion of the marketing margin reserved and protected. This would result in a more stable and consistent interplay among the various levels within the wholesale petroleum industry and allow the "little guy" to continue to operate and not disrupt supply channels. It would also allow the jobbers to continue to provide distribution services to those customers described above that would otherwise not be able to obtain such services from the larger distributors.

Further, because the marketing margin numbers may fluctuate in the future (e.g., Chevron has already indicated it may file a petition under HRS §486H-16(a) for an upward adjustment of the current marketing margin of 18 cpg<sup>2</sup>), HPMA believes a percentage approach may be appropriate to keep the various trade segment marketing adjustment factors in line with each other despite possible future fluctuations.

HPMA disagrees with any argument that marketing margins for any class have no basis in the Gas Cap legislation and are otherwise unnecessary or desirable for the wholesale industry. Any line of argument to prohibit such margin adjustments for different

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<sup>2</sup> See Chevron U.S.A. Inc.'s Response to Order No. 22056 filed November 1, 2005 at p. 5.

classes of trade would leave the members of HPMA without any assurance whatsoever that they would have sufficient margins available to them under the caps to continue operating their businesses. Rather, HPMA supports margin adjustments as ICF recommends for the bulk, dealer tank wagon, and rack classes of trade as stated above, to better reflect and protect actual marketplace conditions.

B. Zone Price Adjustment Factors Also Require Protection. Although the PUC has requested proposals on the marketing margin factors, HPMA believes the PUC should at the same time consider protections for the zone price adjustment factors provided under HRS §486H-13(h)-(i). Zone price adjustments are based on cost only, not including overhead and capital costs, and with no marketing margin taken into account. Suppliers are afforded an additional markup based on the costs of barging to a neighbor island, use of a terminal, and truck delivery to end users. For suppliers and jobbers, there is no margin associated with this value added service. In the case of jobbers, the PUC has left to the discretion of suppliers how much of this Zone Price adjustment to pass through in rack pricing. In practice, this leaves the economic fate of the jobbers subject to the suppliers' quest for profitability, potentially leading to the demise of the jobber industry. Worse, it is clear from the PUC's derivation of the Zone Price adjustment factor (i.e., solely barge, terminal and trucking costs), that the entity performing each of these services should be compensated accordingly. However, jobbers always provide the trucking component, and in some cases the barge and terminal components. Yet, they are potentially cut out of recovering even these costs, since suppliers remain in control of the pricing decisions. The PUC needs to fix both this cost allocation inequity through rack pricing as suggested above, and establish protections for allocating a marketing margin to jobber sales.

II. PROPOSAL TO ADJUST HRS § 486H-13 FACTORS TO INCLUDE THE ADDITION OF ETHANOL REQUIREMENTS WHICH TAKE EFFECT ON OR ABOUT APRIL 2006.

On an industry-wide basis, HPMA is concerned that if the PUC continues to use the baseline price of gasoline from the U.S. Mainland price point markets of Los Angeles, New York Harbor, and the U.S. Gulf Coast, such market prices will fail to reflect the additional cost impacts associated with using Reformulated gasoline Blendstock for Oxygenate Blending (RBOB) necessary for purposes of ethanol blending.<sup>3</sup> Regular gasoline, as opposed to RBOB, is unsuitable for blending with ethanol. Therefore, the baseline pricing relied upon by the PUC must take into account baseline markets that price RBOB rather than regular gasoline to provide a more accurate baseline.

Further, the PUC must take into account the direct ethanol cost component sold to retail stations. Given the lack of local production capabilities, ethanol product will likely be brought into the State by refiners and importers with terminal facilities and such product will vary in price based on the going market and negotiated terms. Ethanol product will come from various suppliers around the world including the Caribbean, Brazil and other locations. It would be inaccurate for the PUC to use the same import parity concept that it has elected to use for the wholesale gas base price caps as the timing will be totally off if an import comes from the Caribbean or Brazil and the ethanol product cap is set based on the prior week's U.S. mainland prices. Rather, the PUC should adopt an "actual cost" mechanism to better reflect the cost impacts that the ethanol blending mandate will impose on the Hawaii wholesale petroleum industry (at least until local production is established so an import parity approach will be workable).

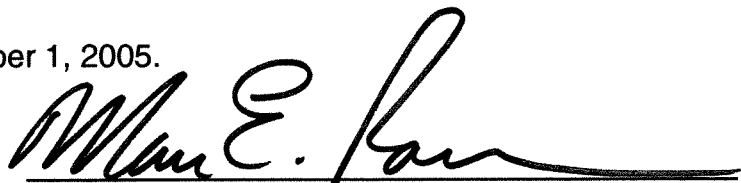
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<sup>3</sup> Similar to CARBOB, California reformulated gasoline blendstock for oxygenate blending, as defined in the ICF Report.

At the jobber level, HPMA believes the mandatory ethanol blending requirements imposed by HRS §486J-10 and Title 15, Chapter 35 of the Hawaii Administrative Rules will impact each HPMA jobber member differently in terms of cost, supply and storage. For example, some jobber customers are simply not going to be able to receive ethanol blended fuel into their systems due to the water problems associated with its storage. As a result, jobbers will have to incur additional carrying and delivery costs in attempting to satisfy the needs of such customers or invest additional capital into their customers' systems to accommodate such deliveries.

Therefore, HPMA's members will be submitting directly to the PUC under seal their respective confidential individual proposals as to what impact such members believe the mandatory ethanol blending requirements of HRS §486J-10 and the implementing regulations will have on their business and the appropriate adjustments that should be made to the HRS §486H-13 factors to address these additional impacts.

DATED: Honolulu, Hawaii, December 1, 2005.

A handwritten signature in black ink, appearing to read "Kelly G. Laporte", written over a horizontal line.

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CERTIFICATE OF SERVICE

I hereby certify that on December 1, 2005, I served copies of the foregoing, together with this Certificate of Service, either by United States mail, postage prepaid, or by hand-delivery to the following:

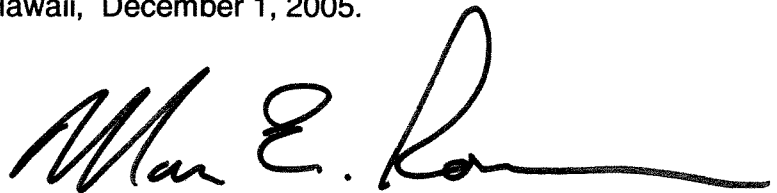
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A handwritten signature in black ink, appearing to read "Marc E. Rousseau", written over a horizontal line.

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